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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

No. 401

In the Matter of
CONSOLIDATED ROCK PRODUCTS CO., a Delaware corporation,
Debtor.

UNION ROCK COMPANY, a corporation
Subsidiary.
and
CONSUMERS ROCK & GRAVEL COMPANY, INC., a corporation,
Subsidiary.

CONSOLIDATED ROCK PRODUCTS CO., a corporation, and EDWARD E. HATCH and LOUIS VAN GELDER, composing the Preferred Stockholders Committee of Consolidated Rock Products Co.,
Petitioners,

v.

E. BLOIS du BOIS,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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E. BLOIS du BOIS,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Consolidated Rock Products Co., a corporation, organized under the laws of the State of Delaware, and Edward E. Hatch and Louis Van Gelder, composing the preferred stockholders committee of Consolidated Rock Products Co., as your petitioners, respectfully pray that a writ of certiorari issue to review a judgment entered June 19, 1940, in the United States Circuit Court of Appeals for the Ninth Circuit in case No. 9,000, entitled "E. Blois du

Bois, an objecting bondholder of record to the Plan of Reorganization, appellant, vs. Consolidated Rock Products Co., a corporation; F. B. Badgley, Colonel R. E. Frith, T. Fenton Knight, and Walter S. Taylor, composing the Union Rock Company Bondholders' Protective Committee; Wm. D. Courtright, Fred L. Dreher, F. J. Gay and Guy Witter, composing the Consumers Rock and Gravel Company, Inc. Bondholders' Protective Committee; and Edward E. Hatch and Louis Van Gelder, composing the Preferred Stockholders Committee of Consolidated Rock Products Co., appellees," and the order of said court directing modification of opinion and denying petition for rehearing dated Monday, August 5, 1940.

Opinions Below.

The first opinion of the Circuit Court of Appeals affirming the trial court is reported in 107 Fed. (2d) 96, Advance Sheet; the second opinion of the Circuit Court of Appeals reversing the trial court is not yet reported but appears in the record at page 365; and order directing modification of opinion and denying opinion for rehearing is not yet reported but appears in the record at page 382.

Jurisdiction.

The final judgment of the Circuit Court of Appeals was filed on June 19, 1940; a petition for rehearing was filed in the Circuit Court on July 19, 1940 and denied on August 5, 1940. This petition for writ is filed within three months after the filing of both the final opinion and the order denying the rehearing. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

(1) Does the rule of "fair and equitable" Plans of Reorganization established in *Case v. Los Angeles Lumber Products Co., Limited,* 308 U. S. 106, require or permit the Circuit Court of Appeals to find that a plan is unfair and inequitable *as a matter of law* where the debtor is found solvent, where the stockholders are found to have an equity, and where they are permitted to participate because of that equity and because of a compromise of a *bona fide* dispute.

(2) Can the Circuit Court of Appeals overrule the findings of fact of the trial court and thereby usurp its functions where a corporation is found solvent, where stockholders have been found to have an equity, where there was found to be a compromise of a *bona fide* dispute and where the record shows that the trial court acted on an informed and independent judgment.

(3) May a corporation being reorganized under Section 77B, 48 Stat. 912, 11 U.S.C.A. §207, of the Bankruptcy Act and having subsidiaries reorganized in the same proceeding, merge the various properties of all the companies into one company, substituting for separate bond issues on the separate company's properties, one bond issue on all the properties.

Statement.

Briefly stated, the facts upon which the foregoing questions arose are as follows. (The facts are taken from the said first opinion of the Circuit Court of Appeals in this matter, dated Nov. 4, 1939 and reported in 107 Fed. (2d) 96, Advance Sheets.)

In the year 1929 Union Rock Company (hereinafter referred to as Union), Consumers Rock & Gravel Company, Inc. (hereinafter referred to as Consumers), and Reliance Rock Company (hereinafter referred to as Reliance), all Delaware corporations, were engaged in the business of producing and marketing rock, sand, and gravel in Southern California as independent and competing organizations. Union and Consumers each then had outstanding a bonded debt consisting of first mortgage gold bonds. Reliance had no bonded indebtedness. On January 28, 1929, Consolidated Rock Products Co. (hereinafter referred to as Consolidated), was incorporated under the Delaware corporation laws for the purpose of acquiring the issued and outstanding shares of the capital stock of Union, Consumers, and Reliance. This it did, with the exception of a few shares, by issuing to various brokerage houses in exchange therefor 280,000 shares of its preferred stock and approximately 396,000 shares of its common stock. The brokerage houses in turn sold the Consolidated stock to the public for some seven million dollars. In addition Consolidated sold 20,000 shares of its preferred stock to the public for $500,000.00, to provide working capital. The properties of the three companies were appraised in 1928 at fifteen million dollars. At the time Consolidated acquired the stock of said three companies, the bonded indebtedness of Union and Consumers, above mentioned, was outstanding.

Consolidated, owning or controlling substantially all of the outstanding stock of these three companies, designated their respective boards of directors and officers. Under date of July 15, 1929, effective as of April 1, 1929, Consolidated made with these three companies what was termed

an operating agreement. Under said agreement the three companies ceased operations; all cash, securities, notes, accounts receivable, contracts, etc., of said companies were to be turned over to Consolidated, and that company was to maintain in first class condition the properties of the owning companies. In addition, Consolidated was to keep proper books and accounts so as to record, in accordance with approved accounting methods, the transactions between the parties to the agreement, including entries effecting depreciation, depletion, amortization, and obsolescence of all the properties. This operating agreement also provided:

> "It is distinctly understood and agreed that this agreement is entered into for the mutual benefit of the parties hereto, that it is not made expressly or at all for any third person as that term is used in Section 1559 of the Civil Code of the State of California, and that said parties hereto and their respective successors and assigns alone shall exercise and enjoy the rights and privileges hereof."

Under date of February 16, 1933, a "Modification of Operating Agreement" was entered into by these companies for the evident purpose of fixing a lower basis of depreciation than that theretofore placed upon the properties in order to keep within the letter of the trust indenture securing the bond issues and for accounting and income tax convenience. The "Modification" provided for an appraisal and specified that the appraised valuation was to be the basis of depreciation, regardless of book values, that the depreciation was to be credited to the owning companies, and that payment thereof might be made over

a period of ten years, at the option of the operating company.

On March 15, 1937, the following securities were outstanding and are affected by the plan of reorganization:

(a) Union bonds in the aggregate principal amount of $1,979,500.00.

(b) Consumers bonds in the aggregate principal amount of $1,200,500.00.

(c) 285,947 shares of preferred stock of Consolidated.

(d) 387,455 shares of common stock of Consolidated.

Default was made in the payment of the principal of the Union bonds which became due and payable on September 1, 1933, and default was made in the payment of semi-annual interest installments due and payable on said bonds on March 1, 1934. Default was made in the payment of semi-annual interest installments due and payable on the Consumers bonds on July 1, 1934.

E. Blois du Bois, the objecting bondholder and respondent herein, owns and holds Union bonds of the face value of $150,000.00, which he purchased at various times between September 20, 1934, and December 9, 1935, at an average cost of $145.00 per $1000 par value. Between July 1, 1934, and April 17, 1935, he purchased $31,500.00 face amount of Consumers bonds at an average cost of $210.00 per $1000 par value. All of said bonds were held and owned by said du Bois at the time of the confirmation of the plan.

On May 24, 1935, Consolidated, Union, and Consumers filed in the court below their respective petitions for relief.

under Section 77B of said Bankruptcy Act. No admission or allegation was made by said corporation, or any of them, that their assets amounted to less than their liabilities, but allegations were made that their assets had a value in excess of the amount which could be realized at that time upon a forced sale thereof or upon liquidation, and that if said corporations were not reorganized, the rights of their creditors and stockholders would be seriously impaired. Allegations were likewise made that said corporations were unable to meet their debts as they matured, and that they desired to effect a plan of reorganization pursuant to said Section 77B. After due notice and hearing, the debtor was continued in possession.

The Union bondholders, Consumers bondholders, and holders of Consolidated preferred stock each formed a committee to protect their respective interests. In presentation of a plan of reorganization, each group sought to preserve and advance its own interests and great difficulty was experienced in reaching a compromise of these conflicting interests. Finally, under date of March 15, 1937, the Consumers committee, the Union committee, and Consolidated submitted a plan of reorganization which is that before the Court herein. On August 25, 1937, the respondent herein filed objections to the said plan of reorganization. Consolidated and bondholders' committees of both Union and Consumers filed a joint petition for hearing, consideration and confirmation of the plan of reorganization, and requested therein that the objections to said plan be heard at the same time. On November 3, 1937, the court below filed an order referring said plan of reorganization, and the objections thereto (except objections going to constitutionality), to a special master for findings and

report: The special master held a hearing, made findings of fact, and recommended that the plan of reorganization be confirmed. Respondent herein offered objections to said special master's report and filed a motion to reopen the hearing. This was denied by the trial court August 5, 1938. On August 8, 1938, the trial court filed a "Memorandum of Conclusions" in which it was held that the proposed plan of reorganization was fair, just and equitable; the exceptions to the report of the master were denied; the report approved, and the plan confirmed. On September 8, 1938, the court made its findings of fact and order in the case.

The provisions of the Plan of Reorganization material here are as follows: A new corporation will be formed to which all of the assets of Consolidated and its subsidiaries will be transferred. The bondholders of Union and Consumers will surrender their bonds, cancel accrued interest to April 1, 1937, and receive in lieu of each such bond a new bond with 5% cumulative interest in one-half of the principal amount of the original bond; new preferred stock of a par and preference value equal to one-half of the principal amount of the original bond and common stock purchase warrants. The new bonds and the new preferred stock will be issued by the new corporation and will constitute a lien and a preference, respectively, against all of the assets of the new corporation. The old preferred stockholders of Consolidated will receive one share of common stock of the new corporation for each share of old preferred stock. The old common stockholders of Consolidated will receive stock purchase warrants entitling them for a limited time to purchase for cash one share of new common stock for each five shares

of old common owned. Consolidated surrenders for cancellation 166,000 par value of Union and Consumers bonds and transfers all of its assets to the new corporation to become subject to the aforesaid lien and preference of the Union and Consumers bondholders.

Respondent herein appealed to the Circuit Court of Appeals for the Ninth Circuit, which after briefs and arguments thereon, affirmed the order of the trial court on November 4, 1939. The case of *Case v. Los Angeles Lumber Products Company (supra)*, was decided shortly thereafter. The Circuit Court of Appeals thereupon granted a rehearing on briefs but without oral argument and after submission of briefs on the basis of said decision reversed itself and disapproved the plan.

Briefly summarized, the facts are:

1. Union and Consumers with outstanding bond issues at the time their capital stock was acquired by Consolidated. Reliance has no bonded debt.

2. *Consolidated with no bonded debt at any time,* its financial structure consisting of *preferred and common stock only.*

3. No assumption by Consolidated of the bonded indebtedness of Union or Consumers.

4. The only possible liability by Consolidated to Union or Consumers—*not the bondholders*—arising out of an operating agreement.

(a) Said operating agreement providing that it is for the mutual benefit of the parties to it, *i. e.,* Consolidated, Union, Consumers and Reliance, respectively and *not for the benefit of any third party.*

(b) The operating agreement modified by an agreement of February 19, 1933 providing for

I. A method of determining depreciation on a fair basis rather than book value at the time of acquisition, and

II. A method of liquidating any sum which might be due thereunder.

5. A plan of reorganization evolved after several years of bitter bickering and threats of litigation.

6. Requisite consents filed in the proceeding by all interested parties including the bondholders of Union and Consumers.

7. Extended hearings before a special master on the plan; extended hearings in the trial court on the special master's report recommending confirmation and then the confirmation.

8. An appeal by one objector who acquired his bonds at an average cost of fifteen cents on the dollar after default and just before and after the 77B proceedings.

9. The Circuit Court of Appeals affirming the trial court.

10. The Circuit Court of Appeals reversing itself and the trial court as a result of the case of *Case v. Los Angeles Lumber Products Co. (supra)*.

11. The basis for the Circuit Court of Appeals reversal of itself and the trial court being

(a) The plan is not fair and equitable as a matter of law based on the authority of *Case v.*

Los Angeles Lumber Products Co. (supra) even though the stockholders are found to have an equity and even though there was a compromise of a *bona fide* dispute.

(b) The plan cannot be confirmed because it provides for a blanket mortgage to cover all the properties of all the companies in exchange for the bonds against the properties of the two separate companies.

Specifications of Error to Be Urged.

1. The Circuit Court of Appeals erred in finding that the plan here involved is unfair and inequitable as a matter of law because of the rule established in *Case v. Los Angeles Lumber Products Co. (supra)*, in the face of findings of solvency of the debtor, an equity in the stockholders and the compromise of a *bona fide* dispute.

2. The Circuit Court of Appeals erred in finding that the plan was unfair and inequitable as a matter of law because by virtue of the "full priority" rule established in *Case v. Los Angeles Lumber Products Co. (supra)*, the two original bond indentures could not be merged into one new indenture covering all the properties of all the companies.

3. The Circuit Court of Appeals erred in finding the plan was unfair and inequitable upon the findings before the court because by so doing it usurped the functions of the trial court.

Reasons Relied Upon for Allowance of the Writ.

It is respectfully submitted by your petitioners and relied upon as a reason for the granting of the writ that:

1. The act of the Circuit Court of Appeals in reversing its own decision and that of the trial court on the basis of the authority of the case of *Case v. Los Angeles Lumber Products Co. (supra)*, erroneously construes that decision in that:

(a) It holds *that as a matter of law* it is required to disapprove a plan of reorganization of a *solvent* company wherein its stockholders are given the right to salvage an equity.

(b) It holds *that as a matter of law* it is required to disapprove a plan in which the stockholders of a company with *no liens against its properties* are permitted to participate in the plan as a result of a compromise of an alleged liability of that company to its subsidiaries *against whose properties the liens exist.*

(c) It holds *that as a matter of law* it is required to disapprove a plan involving a solvent corporation because in its opinion there was little merit in a controversy or in the compromise thereof.

(d) It holds *that as a matter of law* two separate mortgage liens cannot be merged into one new blanket lien against the properties of the same companies and another when these companies are merged.

2. The act of the Circuit Court of Appeals in disapproving the plan on the basis of the authority of *Case v. Los Angeles Lumber Products Co. (supra)*, after approving the plan prior to that decision, makes that decision the sole and direct basis for reversal and therefore establishes the "fixed principle" rule of that

case as applying as a fixed principle in 77B cases involving solvent corporations and compromises among the interested parties.

3. The act of the Circuit Court of Appeals in disapproving the plan results in a shameful inequity toward the stockholders of a solvent corporation in favor of bondholders, not of that corporation, but of its subsidiaries and is tantamount to the substitution of that court's judgment on a question of fact for the judgment of the parties involved, the special master and the trial court. This is contrary to *In re 620 Church St. Bldg. Corporation, et al.*, 299 U. S. 24, 27.

4. The act of the Circuit Court of Appeals in disapproving the plan is of important public interest and presents a fundamental question of law involving numerous plans of reorganization of solvent corporations now pending which will remain in an uncertain status unless and until this Court exercises its power of supervision and hears and determines this question.

5. The act of the Circuit Court of Appeals in disapproving the plan, if permitted to stand, effectually destroys the possibility of any reorganization under Section 77B even in solvent corporations unless it conclusively appears from the record that creditors have been taken care of in full before stockholders are permitted to participate. This effectually destroys the purpose of the adoption of Section 77B.

Wherefore, your petitioners respectfully pray that this petition be granted.

Dated: September ....., 1940.

PAUL R. WATKINS,
DANA LATHAM,
Attorneys for Petitioners.

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Petitioners,

v.

E. BLOIS du BOIS,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Opinions Below.

The opinion of the District Court was filed September 8, 1938 and is not yet reported but appears in the transcript at page 231. The first opinion of the Circuit Court of Appeals affirming the trial court was filed November 4, 1939 and reported in 107 Fed. (2d) 96, Advance Sheets. The second opinion of the Circuit Court of Appeals reversing its earlier opinion was filed June 19, 1940 and is not yet recorded but appears in the transcript at page 365. The order denying petitioner's petition for rehearing was entered on the 5th day of August, 1940.

Jurisdiction.

The final judgment of the Circuit Court of Appeals was filed on June 19, 1940; a petition for rehearing was filed in the Circuit Court on July 19, 1940 and denied on August 5, 1940. This petition for writ is filed within three months after the filing of both the final opinion and the order denying the rehearing. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

(1) Does the rule of "fair and equitable" Plans of Reorganization established in *Case v. Los Angeles Lumber Products Co., Limited,* 308 U. S. 106, require or permit the Circuit Court of Appeals to find that a plan is unfair and inequitable *as a matter of law* where the debtor is found solvent; where the stockholders are found to have an equity, and where they are permitted to participate because of that equity and because of a compromise of a *bona fide* dispute.

(2) Can the Circuit Court of Appeals overrule the findings of fact of the trial court and thereby usurp its functions where a corporation is found solvent, where stockholders have been found to have an equity, where there was found to be a compromise of a *bona fide* dispute and where the record shows that the trial court acted on an informed and independent judgment.

(3) May a corporation being reorganized under Section 77B, 48 Stat. 912, 11 U.S.C.A. §207, of the Bankruptcy Act and having subsidiaries in the same proceeding, merge the various properties of all the companies into one company, substituting for separate bond issues on the separate company's properties, one bond issue on all the properties.

Statutes Involved.

The statute here involved is Section 77B of the Bankruptcy Act, 48 Stat. 912, 11 U. S. C. A. §207.

Statement of Case.

The essential facts of the case herein are stated in the accompanying Petition for Writ of Certiorari and in the interest of brevity only the summary thereof is here repeated. It is as follows:

1. Union and Consumers with outstanding bond issues at the time their capital stock was acquired by Consolidated. Reliance had no bonded debt.

2. *Consolidated with no bonded debt at any time,* its financial structure consisting of *preferred and common stock only.*

3. No assumption by Consolidated of the bonded indebtedness of Union or Consumers.

4. The only possible liability by Consolidated to Union or Consumers—*not the bondholders*—arising out of an operating agreement.

(a) Said operating agreement providing that it is for the mutual benefit of the parties to it, *i. e.,* Consolidated, Union, Consumers and Reliance, respectively and *not for the benefit of any third party:*

(b) The operating agreement modified by an agreement of February 19, 1933 providing for

I. A method of determining depreciation on a fair basis rather than book value at the time of acquisition, and

II. A method of liquidating any sum which might be due thereunder.

5. A plan of reorganization evolved after several years of bitter bickering and threats of litigation.

6. Requisite consents filed in the proceeding by all interested parties including the bondholders of Union and Consumers.

7. Extended hearings before a special master on the plan; extended hearings in the trial court on the special master's report recommending confirmation and then the confirmation.

8. An appeal by one objector who acquired his bonds at an average cost of fifteen cents on the dollar after default and just before and after the 77B proceedings.

9. The Circuit Court of Appeals affirming the trial court.

10. The Circuit Court of Appeals reversing itself and the trial court as a result of the case of *Case v. Los Angeles Lumber Products Co. (supra).*

11. The basis for the Circuit Court of Appeals reversal of itself and the trial court being

(a) The plan is not fair and equitable as a matter of law based on the authority of *Case v. Los Angeles Lumber Products Co. (supra)* even though the stockholders are found to have an equity and even though there was a compromise of a *bona fide* dispute.

(b) The plan cannot be confirmed because it provides for a blanket mortgage to cover all the properties of all the companies in exchange for the bonds against the properties of the two separate companies.

Specification of Error.

1. The Circuit Court of Appeals erred in finding that the plan here involved is unfair and inequitable as a matter of law because of the rule established in *Case v. Los Angeles Lumber Products Co. (supra)*, in the face of findings of solvency of the debtor, an equity in the stockholders and the compromise of a *bona fide* dispute.

2. The Circuit Court of Appeals erred in finding that the plan was unfair and inequitable as a matter of law because by virtue of the "full priority" rule established in *Case v. Los Angeles Lumber Products Co. (supra)*, the two original bond indentures could not be merged into one new indenture covering all the properties of all the companies.

3. The Circuit Court of Appeals erred in finding the plan was unfair and inequitable upon the findings before the court because by so doing it usurped the functions of the trial court.

Arguments and Authorities in Support of Petition.

We intend to base our argument, in the main, on the applicability of *Case v. Los Angeles Lumber Products Co., Limited* (308 U. S. 106). (Because of frequent reference to this case we shall refer to it as the *"Lumber Company"* case.) We do this because the Circuit Court of Appeals affirmed the plan prior to that decision and reversed itself afterwards solely on the basis of that decision.

With all due respect for the Circuit Court we must say that, in our opinion, it did not have the facts of our case clearly in mind. That court's final decision, as well as its earlier one affirming the plan, plainly shows this. In this connection we also direct this Court's attention to the fact that on petition *joined in by all parties* the Circuit Court's final opinion was modified to eliminate obvious fact errors therein. [R. 382.] It is also important that the fact distinction between the two cases clearly appear because our case has been reversed on the authority of the *Lumber Company* case *as a matter of law*. Therefore, let us first set out the essential facts in both cases.

Los Angeles Lumber Products Co.*

I. Securities affected by the plan:

(a) $3,800,000 principal and interest first m
gage bonds.

(b) 57,000 shares of Class A Common Stock

(c) 5,000 shares of Class B Common Stock.

II. Value of enterprise and solvency:

(a) Value of all properties of debtor $830,(
par value of bonded debt, $3,800,000. (
court finds that liquidation at full g
concern value will pay the bondholders
25% of their claim.) (Decision pages
119.)

(b) The debtor is found to be insolvent bot
the equity and in the bankruptcy se
(This court characterizes it as "hopele
insolvent.") (Decision page 124.)

III. Justification for the 23% participation of com
stock.

(a) A contract between the interested pa
antedating the 77b proceedings and defer
foreclosure provided for the plan of reor
ization.

(b) Avoidance of expense and damage of f
closure.

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*These facts and figures are taken from this Court's de
in *Case v. Los Angeles Lumber Products Co.* (*supra.*)

Consolidated Rock Products and Subsidiaries*

I. Securities affected by the plan:

Consolidated	Union	Consumers
85,000 shs. pfd. stock 87,000 shs. com. stock (no creditors)	Common Stock (No. of shares immaterial) Bonds—1,970,000 (No other creditors)	Common Stock (No. of shares immaterial) Bonds—1,200,000 (No other creditors)

II. Value of enterprise and solvency:

Consolidated	Union	Consumers
a) Value— $850,000 exclusive of good will and trade name. [R. 281-2.]	$2,200,000	$1,150,000
b) Bonded Debt— No bonded debt	$2,330,000 (Principal and accrued interest)	$1,390,000 (Principal and accrued interest)

c) Solvency

Union and Consumers insolvent; Consolidated enterprise solvent. [R. 245.]

III. Justification of participation by preferred stockholders of *Consolidated:*

(a) Even assuming that the bondholders can reach assets of Consolidated the enterprise is solvent by $480,000 (summary above).

(b) If the bondholders cannot reach the assets of Consolidated its preferred stockholders contributed $850,000.00 plus good will and trade name valued at $500,000.00 [R. 281-2.]

*Unless otherwise designated these figures are from the Circuit Court's Opinion dated November 4, 1939.

Los Angeles Lumber Products Co.* (cont'd).

(c) Maintenance of a going concern.

(d) Stockholders had financial standing and influence beneficial to corporation.

IV. Financial structure under the plan:

(a) 640,000 shares of $1.00 par value stock (to the bondholders).

(b) 188,000 shares of $1.00 par value common stock (to the Class A stockholders without subscription or assessment).

*These facts and figures are taken from this Court's dec in *Case v. Los Angeles Lumber Products Co.* (*supra.*)

…dated Rock Products and Subsidiaries* (cont'd).

(c) In order to reach Consolidated's assets each bondholder group must foreclose its lien, establish a deficiency, if any, then succeed in a favorable construction of the operating agreement and the voiding of the modification of the operating agreement.

(d) Consolidated's preferred stockholders contributed more than $7,000,000 to the enterprise, acquired preferred stock subject to no prior lien and should not, under the circumstances, be entirely eliminated.

Financial structure under the plan:

(a) All the assets of all the companies in one new company.

(b) $1,507,000 par value new bonds (this represents one-half of present bonds).

(c) $1,507,000 par value preferred stock (30,140 shares at $50 per share). (This represents one-half of the present bonds.)

(d) 285,000 shares of common stock ($2.00 par value). (To present preferred stockholders of Consolidated.)

(e) Additional shares of common stock to be converted through warrants.

…s otherwise designated these figures are from the Circuit …inion dated November 4, 1939.

Los Angeles Lumber Products Co.* (cont'd).

V. Effect on securities affected by the plan:

(a) Bonds—converted into preferred stock having a par value of $640,000 (roughly of the par value of the cancelled bonds interest thereon).

(b) Stock—Class B stock eliminated (this sented old interest on bonds). Class A obtains 23% of the assets and voting

*These facts and figures are taken from this Court's de in *Case v. Los Angeles Lumber Products Co. (supra.)*

ted Rock Products and Subsidiaries* (cont'd).

ffect on securities affected by the plan:

) Bonds—

1. Full principal converted into one-half bonds and one-half preferred stock against all assets of all companies.

2. Cancels accrued interest in the amount of $625,000.00.

3. Changes interest rate from 6% to 5% and makes it cumulative on the new bonds and non-cumulative on new preferred stock.

4. Eases default provisions but gives bondholders management control on default.

5. Provides for common stock warrants.

) Stock of Union and Consumers—eliminated.

) Common stock of Consolidated—eliminated except for warrant rights.

) Preferred stockholders of Consolidated—

1. Surrenders for cancellation $166,000 par value of bonds of Union and Consumers.

2. Obtains common stock of new company share for share.

3. Becomes subject to prior lien of new bonds and prior claim of new preferred stock.

otherwise designated these figures are from the Circuit hion dated November 4, 1939.

A comparison of the facts in the two cases makes it obvious that the *Lumber Company* case cannot be used as a basis for reversing this case *as a matter of law.* There the court was dealing with but one company in which the stockholders acquired their stock subject to the lien of the mortgage indenture; with a company which was "hopelessly insolvent" having liabilities four times its assets; and with a plan which permitted those stockholders to participate without contribution to the extent of 23% of the value of the enterprise. Here we have three companies; the parent, Consolidated, free of any liens; the subsidiaries insolvent, but the parent and the enterprise as a whole, solvent [R. 245]; original purchase by the preferred stockholders of their stock free and clear of any lien; grave question as to whether the parent has any liability to its subsidiaries on which the bondholders may realize; a full preservation of the principal of the bonds; a full priority of the bondholders interest over preferred stockholders of Consolidated even though the bonds are not a lien against that company's properties.

The Effect of the Los Angeles Lumber Products Company Decision.

The opening statement in the *Lumber Company* decision precludes the Circuit Court of Appeals from reversing its decision and the trial court's in this case *as a matter of law.* That statement is:

> "These cases (the interlocutory order and the final order) present the question of the conditions under which stockholders may participate in a plan of reorganization under §77B—where the debtor corporation is insolvent both in the equity and in the bankruptcy sense." (Pages 108-9. Underscoring and portion in parenthesis ours.)

In addition thereto and with reference to the inapplicability of the *Lumber Company* decision in the light of the trial court's findings we find the following statements therein:

> "The District Court found that the debtor was insolvent both in the equity sense and in the bankruptcy sense." (Page 112.)
>
> "We think that as a matter of law the plan was not fair and equitable. At the outset it should be stated that where the plan is not fair and equitable as a matter of law it cannot be approved by the court." (Page 114.)
>
> "We come then to the legal question of whether the plan here in issue is fair and equitable within the meaning of that phrase as used in §77B. We do not believe it for the following reasons. Here the court made a finding that the debtor is insolvent not only in the equity sense but also in the bankruptcy sense. Admittedly there are assets not in excess of $900,000 while the claims of the bondholders for principal and interest are approximately $3,800,000. Hence even if all the assets were turned over to the bondholders they would realize less than 25% on their claims. Yet in spite of this fact they will be required, under the plan, to surrender to the stockholders 23% of the value of the enterprise." (Page 119. Underscoring ours.)

Throughout this entire decision repeated reference is made to other decisions on the rule in such cases. In every instance these decisions involve *insolvent* corporations. None of them involves a solvent corporation and none of them involves an intercorporate relationship in any way analogous to that found in the case at bar.

There are numerous statements in the *Lumber Company* decision which are definite authority for the approval of a plan of the character here involved. They seem to us to be sufficiently definite on such matters to deprive the Circuit Court of Appeals of the right to reverse the trial court on the record in this case. And we must bear in mind that the *Lumber Company* case and all cases cited thereunder deal with insolvent corporations. We quote the pertinent portions:

> 1. ". . . the function and the duty imposed by the Congress on the District Courts in §77B . . . are no less here than they are in equity receivership reorganizations where this court said 'every important determination by the court in receivership proceedings calls for an informed and independent judgment.' National Surety Co. v. Coriell, 289 U. S. 426, etc." (Page 115.)

The District Court surely exercised informed, independent judgment in the case at bar. Three groups, each adverse to the other (Union bondholders committee, Consumer bondholders committee, and Consolidated), negotiated for years before a plan was evolved which met their approval and subsequently that of the interested parties. The District Court had had this matter under its wing for two years before the plan was presented and well knew the debtors' problems. That court appointed a Special Master who spent days on end hearing testimony and studying the entire problem. That court heard extended arguments on the Special Master's report and after taking the matter under submission for several weeks approved the plan. Surely no one can say that the District Court didn't exercise informed, independent judgment!

2. "And this practical aspect of the problem was further amplified in Kansas City Terminal Railway Co. v. Central Union Trust Co., *supra,* by the statement that 'when necessary, they (creditors) may be protected through other arrangements, which distinctly recognize their equitable right to be preferred to stockholders against the full value of all property belonging to the debtor corporation, and afford each of them fair opportunity, measured by the existing circumstances, to avail himself of this right.' . . . and it also recognized the necessity at times of permitting the inclusion of stockholders on payment of contributions even though the debtor company was insolvent." (Page 117. Underscoring ours.)

In the case at bar, we are dealing with a *solvent debtor* (Consolidated [R. 245]); we are dealing with a corporation whose preferred stockholders purchased their stock subject to *no liens;* we are dealing with a compromise of a claim by bondholders *of subsidiaries* to the assets *of a parent,* under an agreement between the parent and the subsidiaries which provides that it is not made for the benefit of any third parties. We are dealing with a case in which the bondholders, even though they have no lien —only a seriously disputed claim—against the assets of Consolidated are given the prior position against all the property of the subsidiaries *and Consolidated.*

3. "It is, of course, clear that there are circumstances under whch the stockholders may participate in a plan of reorganization of an insolvent debtor . . .

"In view of these considerations we believe that to accord 'the creditor his full right of priority against the corporate assets' where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in money's worth reasonably

equivalent in view of all the circumstances to the participation of the stockholder. The alleged consideration furnished by the stockholders in this case falls far short of meeting those requirements." (Pages 121-2. Underscoring ours.)

As we have stated repeatedly, the debtor here, *Consolidated,* is not insolvent. It has no liens. Its only possible liability to bondholders is indirect and determinable only by establishing a deficiency against the subsidiaries and then litigating the operating agreement with Consolidated Despite this, in the plan now before this Court, the bondholders are given full priority against all the assets including those of Consolidated.

4. "Of course, this is not to intimate that compromise of claims is not allowable in §77B. There frequently will be situations involving conflicting claims to specific assets which may, in the discretion of the court, be more wisely settled by compromise rather than by litigation . . . In sanctioning such settlements the court is not bowing to nuisance claims; it is administering the proceedings in an economical and practical manner." (Page 130. Underscoring ours.)

It is interesting to note this court's footnote reference to *In the Matter of Detroit International Bridge Co., Debtor,* No. 24131, U. S. D. C. E. D. Mich. This plan, approved by the Securities & Exchange Commission has since been approved by the District Court. (30 F. Supp. 127 [1939].) It deals with an *insolvent* corporation in which the stockholders participated because of a compromise of a disputed claim.

It would be difficult to obtain a case whose facts more clearly fit it into the rule here announced than the case

at bar. And this rule governs *insolvent corporations*. In the case at bar we have these significant factors: the debtor, Consolidated, solvent; the debtor with no liens against its properties; the preferred stockholders of debtor acquiring their shares for some $7,000,000 when there were no claims ahead of them; violent disputes over a period of years not only between the bondholders and the preferred stockholders of Consolidated but between the two bondholder groups over the property covered by their respective liens; repeated threats of litigation over these matters; the necessity of legal determination of rights as between the bondholders; the necessity of foreclosing the liens and establishing a deficiency; protracted negotiations and giving and taking until a solution was arrived at; consent of all parties to that solution and then its frustration by one discontented bondholder who acquired his bonds after default, and just before and after the commencement of the proceedings, at fifteen cents on the dollar. [R. 243-244 and 107 Fed. (2d) 96, 98-9, Advance Sheets.] If any lack of *bona fides* can be asserted with respect to anyone; if there is any one trying to establish a nuisance value, it must be objector du Bois, and certainly not petitioner herein.

All of the foregoing pronouncements of this court when dealing with *insolvent corporations* would make it clear that this plan should be confirmed under the rules there established. Any other rule governing §77B reorganizations would effectually destroy its usefulness. It was adopted to prevent the dismemberment of a going concern when a large majority of the interested parties agreed to compromise their differences. It was adopted to prevent frustration of such compromises by precisely the type of minority interest as that of respondent herein.

The Right of Union Bondholders to Participate in Consumers Properties and the Right of Consumers Bondholders to Participate in Union's Properties.

This case should not be permitted to stand as it holds that there can be no merger of divisional mortgages. Little need be said in this court on this point. This point was not even raised before the Circuit Court of Appeals. Even though it had been, there is ample authority for that part of the plan. Even though this question was not before the court in the *Lumber Company* case this court there mentioned one of the questions upon which conditions in *insolvent* corporations often arose was over divisional mortgages. It stated:

> "Close questions of interpretations of after-acquired property clauses in mortgages, preferences in stock certificates, divisional mortgages and the like will give rise to honest doubts as to which security holders have first claim to certain assets. Settlement of such conflicting claims to the *res* in the possession of the court is a normal part of the process of reorganization." (Page 130.)

In the case at bar the question arises because, as a part of the compromise resulting in the plan, all properties of all the companies, including the unencumbered property of Consolidated, are to be conveyed to one corporation; the separate bond issues against the separate properties of the two subsidiaries are to be extinguished and new bonds in lieu thereof are to be issued against

all the assets by the new corporation. This the court condemns *on the basis of the Lumber Company decision.* We quote from the opinion of the Circuit Court:

> "It is obvious that the plan here is condemned by these rules. The trial court found that the property of Union covered by the trust indenture was insufficient to pay the principal and accrued interest of the bonds issued by Union, yet the Union bondholders are deprived of their right to full priority against Union's assets, since Consumer's bondholders and debtor's preferred stockholders are given an interest in Union's property. Likewise the trial court found that the property of Consumers covered by the trust indenture was insufficient to pay the principal and accrued interest of the bonds issued by Consumers, yet the Consumer's bondholders are deprived of their right to full priority against Consumer's assets since Union's bondholders and debtor's preferred stockholders are given an interest in Consumer's property. Exactly in point, as to facts, is Case v. Los Angeles Lumber Company, *supra.*" [R. 377. Underscoring ours.]

This question of divisional mortgages arises most frequently in railroad reorganizations. It was before this court with certiorari denied in the case of *Jameson v. Guaranty Trust Co. of New York,* 20 Fed. (2d) 808 (C. C. A. 7th, 1927), certiorari denied 275 U. S. 569 (1927). In addition thereto two such plans have been approved by the Interstate Commerce Commission since the *Lumber Company* decision. These arose under §77

of the Bankruptcy Act (11 U. S. C. Para. 205), in *Missouri Pacific Reorganizations*, 239 I. C. C. 7 (Jan. 10, 1940), and *Chicago & Northwestern Reorganization*, 236 I. C. C. 575 (Dec. 12, 1939).

As is shown by the above quotation from the Circuit Court of Appeals decision, that court gave as its basis for condemnation of a merger of divisional liens the *Lumber Company* decision. It should not stand. In the case at bar no such point was raised by any party and all parties before the court took the position that continued operation of the entire enterprise as one unit was the most feasible solution [R. 244].

The writ here requested should issue for the following reasons:

1. The Circuit Court of Appeals has bottomed its decision on the *Lumber Company* case and wholly misconstrued the intended application of the principle therein established. The *Lumber Company* decision is the sole basis for the reversal as this same court had approved the plan just prior to that decision.

2. The *Lumber Company* decision, properly applicable as to insolvent corporations, has been applied *as a matter of law* to a solvent corporation where the facts and circumstances are in no way comparable.

3. The Circuit Court of Appeals decision should not be allowed to stand because it vitally affects numerous pending plans of reorganization which must of necessity be thrown into hopeless uncertainty. Particularly is this true where divisional mortgages are involved; where the

working out of stockholders equity in solvent corporations is a part of a plan and where the interested parties to any dispute are attempting to settle their differences and preserve a going concern.

4. The Circuit Court of Appeals decision usurps the functions of the trial court in that while it states that the case is reversed as a matter of law, actually it is reversing the trial court—and itself—on questions of fact. This it cannot do. In the case of *In re 620 Church Street Building Corporation, et al.*, 299 U. S. 24, 27, this court stated:

> "And as the Court of Appeals, if the appeal had been allowed, could have revised the ruling of the Court below only in the matters of law, it necessarily follows—and was conceded at the bar—that petitioners are bound by the findings of fact."

The trial court found the enterprise solvent [R. 245] and it found that there was a *bona fide* dispute which had been settled in good faith [R. 244, 260].

5. The Circuit Court of Appeals decision should not be permitted to stand for equitable reasons. That court, in its first opinion, critically, but aptly, referred to the lone objector here by quoting from *J. S. Farlee & Co., Inc. v. Springfield-South Main Realty Co.*, 1 Cir., 86 Fed. (2d) 931, 936, among other things, the following:

> "If the purpose actuating it in making these purchases is to be judged by its conduct since they were made, it would seem to have been to obstruct and defeat the plan of reorganization unless its wishes were met, irrespective of the wishes of all the other bondholders." (107 Fed. (2d) 96, 104, Advance Sheets.)

While from a strict legal standpoint this objector's position in court must be recognized, we believe and urge that this plan should not be upset for his benefit unless it is patently and seriously defective. Those who have paid full price for their bonds and have lived with this picture for years realized the serious problems confronting all parties when they sat down to their apparently hopeless task of working out a plan which could obtain the requisite approval. Those people were and are aware of the endless negotiations, the interminable hearings before the Special Master and the trial court and the affirming of the plan by the trial court and then by the Circuit Court of Appeals. They must feel that their interests have now been subordinated to the will of a stranger to them and to this company's problems.

We respectfully pray that this Honorable Court take jurisdiction in the premises herein.

Dated: September ....., 1940.

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